THE CITY OF SAN DIEGO
MAYOR JERRY SANDERS

MEMORANDUM

DATE: March 29, 2010

TO: Honorable Mayor Jerry Sanders, Council President Hueso and Members of the City Council

FROM: Jay M. Goldstone, Chief Operating Officer

SUBJECT: Pension Update

Last fiscal year, with the market experiencing volatility, I provided you with a monthly update regarding the impact changes in SDCERS plan assets were having on the City's Pension Plan and the corresponding potential budget implications. While the City has been provided with its fiscal year 2011 Annual Required Contribution (ARC), there is much speculation as to the City's fiscal year 2012 ARC. While this ARC will not be known until sometime after June 30, 2010 and will be based upon the actual experience of the Pension Plan, not just the performance of Plan assets, I thought it would be informative to provide you with the following information. This information is for illustrative purposes only and is not required to be disclosed and to the best of my knowledge is not being provided by any other public agency.

I want to again stress that the actual ARC will be based upon total plan performance as of June 30 of each year.

This information will also be posted on the City's website under the Investor web page.

Attachment

Cc: Jan Goldsmith, City Attorney
Mary Lewis, Chief Financial Officer
Lakshmi Kommi, Director of Debt Management
Andrea Tevlin, Independent Budget Analyst
Mark Hovey, SDCERS Interim Plan Administrator

PENSION UPDATE

This past fiscal year (July 1, 2008 through June 30, 2009) the global financial markets experienced considerable volatility, with a significant decline in market value through March 2009 followed by a significant increase to the present date. During the period that the significant decline was occurring, the City produced monthly updates as to the projected funding status of the City's retirement system which, were provided to the City Council and posted on the City's investor information webpage. (The updates were favorably highlighted in the Independent Consultant's final report dated February 24, 2010.) The monthly updates were provided prior to the release in January 2010 of the most recent actuarial report, which is the June 30, 2009 actual valuation.

The chart that follows shows, for the City's portion of the SDCERS' plan:

- information as of June 30, 2007, June 30, 2008 and June 30, 2009 (the date of the latest available actuarial information), including the funded ratio of plan assets to the actuarial liability
- the market value of plan assets

Funding Status
($ in billions)

	Jun. 30, 2007[1]	Jun. 30, 2008[2]	Jun. 30, 2009[3]
Actuarial Liability	$5.598	$5.963	$6.281
Actuarial Value of Assets	$4.413	$4.660	$4.175
Market Value of Assets	$4.641	$4.409	$3.479
Unfunded Actuarial Liability (UAL)	$1.184	$1.303	$2.106
Funded Ratio	78.8%	78.1%	66.5%

1. Source: June 30, 2007 Actuarial Valuation for the City of San Diego, Produced by Cheiron (Feb. 2008).
2. Source: June 30, 2008 Actuarial Valuation for the City of San Diego, Produced by Cheiron (Feb. 2009).
3. Source: June 30, 2009 Actuarial Valuation for the City of San Diego, Produced by Cheiron (Jan. 2010).

Since June 30, 2009, the financial markets have shown a slow but steady improvement which has had a positive impact on the market value of plan assets. This improvement will help offset a portion of the impact of prior years' market losses, not all of which have yet been captured in the City's Annual Required Contribution ("ARC") because of the actuarial smoothing methodology used. The market value represents, as of the date specified, the value of the plan assets if they were to be liquidated on that date. Unlike the market value, the actuarial value of plan assets is used to smooth the impact of annual investment return performance over multiple years, thereby reducing the impact of annual investment volatility on the City's ARC. Investment return is one component that impacts the ARC each year.

The following table reflects the impact on the City's plan based upon several scenarios regarding the investment rate of return on the plan assets. Because the rate of return is only one of many factors that impact the calculation of the City's ARC, the following numbers are meant for illustrative purposes only. The June 30, 2009 column reflects the current actuarial valuation that will impact the City's fiscal year 2011 budget. The four columns to the right illustrate what the City's UAL, ARC payment and funded ratio would be based upon various hypothetical investment returns assumed for June 30, 2010 while holding all other actuarial valuations constant. As a point of reference, investment returns through December 31, 2009, the first six months of this fiscal year, were 15.8%.

UAL and Funded Ratio Scenarios
(UAL in billions, ARC in millions)

	June 30, 2009[1]	Various Investment Return Assumptions June 30, 2010			
Annual Investment return (FY)	-19.2%	7.75%	15.00%	20.00%	25.00%
UAL	2,106.4	2,356.2	2,293.2	2,249.7	2,206.2
ARC	231.7	257.7	252.0	248.1	244.2
Funded Ratio	66.5%	64.1%	65.0%	65.7%	66.3%

1. Source: June 30, 2009 Actuarial Valuation for the City of San Diego, Produced by Cheiron (Jan. 2010).

As the table makes clear, while holding all other actuarial assumptions constant, even a healthy increase in the market value of SDCERS' plan assets as of June 30, 2010 would have a limited impact on the fiscal year 2012 ARC over fiscal year 2011. This is primarily due to the fact that because of the market smoothing methodology approximately 45% of fiscal year 2009's market loss has yet to be captured in future UAL and ARC calculations and only 25% of any fiscal year 2010 gains will be included in the fiscal year 2012 ARC calculation. The actual ARC in any year will depend on various factors, such as approved salary increases, mortality experience, retirement experience and actual market performance measured as of June 30 of the applicable year.

Actuarial Assumptions. The following are the principal actuarial assumptions used by SDCERS' actuary in preparing the valuation as of June 30, 2009:

1. Investment Return Rate: 7.75% a year, net of administrative expenses, compounded annually.
2. Inflation Rate: 4.00% a year, compounded annually.
3. Interest credited to member contributions: 7.75%, compounded annually.
4. Salary increase rates: 4.00% a year, plus an additional merit component ranging from 0.5% to 8.0%.
5. Annual Cost-of-Living Adjustment: 2% per year, compounded annually.
6. Additional Assumptions: Additional assumptions were used regarding rates of separation from active membership, post-retirement mortality, active member mortality, and rates of retirement.